

**CITY OF LODI
INFORMAL INFORMATIONAL MEETING
"SHIRTSLEEVE" SESSION
CARNEGIE FORUM, 305 WEST PINE STREET
TUESDAY, MAY 23, 2006**

An Informal Informational Meeting ("Shirtsleeve" Session) of the Lodi City Council was held Tuesday, May 23, 2006, commencing at 7:00 a.m.

A. ROLL CALL

Present: Council Members – Beckman, Hansen, Johnson, Mounce (arrived at 7:04 a.m.),
and Mayor Hitchcock

Absent: Council Members – None

Also Present: City Manager King, City Attorney Schwabauer, and Deputy City Clerk Perrin

B. TOPIC(S)

B-1 "Utilities quarterly update"

Electric Utility Director, George Morrow, reported that, since the last quarterly update, two issues have changed the financial condition of the Electric Utility: revenues were lower than anticipated and expenses were higher. In looking at the third quarter (i.e. the end of March 2006), sales revenues were down to \$1.6 million and power costs were up to \$1.6 million. When staff met with the rating agencies, the projection was a \$3.2 million cash balance at year end; however, with these two negative impacts, the cash balance will be \$1.7 million, or \$1.5 million less than anticipated.

In response to Council Member Hansen, Mr. Morrow stated that sales revenue projections were less due mainly to a decrease of \$1.2 million for the period of September to November 2005. The decrease may be attributable to the weather, which was cooler and not as conducive to sales. Additionally, there was much discussion and media attention on the condition of the Utility and the possibility of large rate increases. It is likely that residents conserved their energy as they may have felt the City was in a critical situation. Although conservation and efficiency are desired, it does play a factor in the financial forecast and condition of the Utility.

In response to Council Member Beckman, Mr. Morrow confirmed that Lodi's rate structure is designed with a lower rate for baseline usage and that energy consumed above that baseline is charged at a higher rate. If more citizens conserve and do not progress into the higher tier, it can have an impact on the Utility's budget.

Council Member Hansen stated that Lodi is serious about energy efficiency and it should be factored into the projections and overall management of the Utility.

Mr. Morrow agreed that it may be necessary to adjust the per unit charges so that customers pay more per kilowatt hour, yet their total bill would be lower.

Mayor Hitchcock stated that the City needs a larger reserve in order to manage these types of fluctuations.

Mr. Morrow reported that there was an increase in power supply costs and in payments to the Northern California Power Agency (NCPA). There was a \$1.4 million increase to the City in charges related to the California Independent System Operator (CAISO), which is a regional transmission organization responsible for management of the electric grid of the transmission system and for ensuring that those who bring transmission to the grid recover their costs. Most of the transmission in California is investor-owned utilities who are able to input their costs into the CAISO, which is then passed onto the users of the system. Municipal utilities are large users of the system and pay a proportionate share of the costs. Staff, in conjunction with NCPA, is working with CAISO in getting its cost structure more

manageable, as there are additional costs anticipated in the future. NCPA's budget this year for CAISO-related costs was \$22 million; next year it will increase to over \$40 million. The CAISO has an independent board that is regulated by the Federal Energy Regulatory Commission (FERC) in Washington DC, and it does not respond well to the users in California.

Mayor Pro Tempore Johnson questioned how CAISO can justify these significant increases, to which Mr. Morrow replied that there has been a substantial amount of new transmission built in California, for which the per unit cost is quite expensive. The rate of returns has increased as interest rates or the cost of money has gone up, and the allowable rate of profit for investor-owned utilities has increased. Additionally, the CAISO has assumed more functions and is broadening its reach beyond raw transmission. It is looking at reliability in the state and, at some point, will manage power plants. Because of these reasons, its administrative costs have increased significantly. Utilities and NCPA are very concerned and are utilizing all regulatory forums, particularly at FERC, to address the issue.

Council Member Hansen added that this has been a continuous battle and utilities are caught between FERC and CAISO, as neither will take responsibility. The CAISO volunteer board relies solely on its staff regarding input from municipal utilities.

Mr. Morrow stated that FERC prefers ISOs and tends to favor costs, goals, and plans submitted for approval by ISOs. City staff recently met with members of FERC in Washington DC to complain that municipal utilities are not being included in the process.

The \$7 million negative net income for Electric Utility will be made up using reserves, as well as the general operating reserves (GOR) at NCPA. With the aid of an overhead presentation (filed), Mr. Morrow reviewed the revenue and expense projections. Projected capital expenses and budgeted expenses are accounted for separately to track the general operating expenses for capital items, as well as the bond revenues. The capital costs are projected to be \$1.5 million and "other" costs are \$9.1 million, for a total of \$10.6 million.

The GOR is the amount of money Lodi has in an NCPA account that holds the excess of what the City is billed for on a monthly basis. It tends to increase by \$75,000 to \$100,000 per month. At the start of the year, the balance of the GOR was \$266,000, and it increased to \$2.7 million at the end of this quarter. Much of that growth was due to a large settlement in a Pacific Gas & Electric case, which increased the reserve by \$1.8 million. Staff intends to use most of the GOR to assist in the Utility's liquidity.

In response to Council Member Hansen, Mr. Morrow explained that NCPA submits an estimated bill to the City on an advanced basis, the City makes the payment to NCPA, and when the actual expenses are realized, any difference is placed into this account. NCPA's financial advisors are looking into the amount of reserves that members keep in the GOR so that utilities can survive fluctuations due to volatility in the power market. NCPA is not concerned with where the reserves are housed, but that there are enough reserves on hand.

Mr. Morrow reported that the Utility has closed its open position for next year. The last large purchase was on May 10, which resulted in a closed position of 95%. This provides a cushion if the loads are not as high as projected or if the market declines dramatically. It is anticipated that next year's budget will be balanced; although, it will leave little contribution to reserves. Lodi's percentage of the CAISO costs has been built into next year's budget, and NCPA's budget projections have decreased for next year. Staff anticipates a reduction in power supply costs and has analyzed the sales per kilowatt hour and by customer class to arrive at a more accurate, realistic number. The decreases in revenue will match the decrease in power supply costs. Additionally, the capital costs will be rolled into the rates this year to cover general capital projects that are accomplished during the normal course of business.

In response to Mayor Hitchcock, Mr. Morrow stated that there is \$11 million remaining in the Certificates of Participation fund, and Electric Utility anticipates using \$3.5 million for the Killelea Substation revitalization, \$500,000 on other large capital projects, and \$1.5 million to be transferred this fiscal year.

In response to Council Member Hansen, Mr. Morrow reported on the status of the Resource 500 project and the Lodi combined cycle project at White Slough. Calpine has a list of preferred projects that it wants to divest itself of; however, it no longer wants to sell the Resource 500 project because it is a great asset with a good operating history and efficiency. Much of the ground work has been completed on this so that an offer can be made should it become available. On the White Slough project, changes in the industry have split the NCPA members. Some are in the SMUD Western Area Power Administration sub-control area and others, including Lodi, are in the CAISO area. This plant would be in the CAISO control area, and some members do not want to participate if that is the case. Staff has also researched other base load type projects, such as coal fired energy; however, California regulations make it difficult for utilities to be involved in any type of energy that might have carbon dioxide emissions. Utilities need a base load resource that is inexpensive to operate, because it runs thousands of hours a year. In California, the base load plants tend to be natural gas fired plants that are combined cycle; however, it is subject to extreme volatility in natural gas prices. Lodi has no base load type resource that it can run 8,760 hours a year. The Resource 500 or the project at White Slough could fill that need, but it too would be subject to the price of gas.

In answer to Mayor Hitchcock regarding global warming, Mr. Morrow stated that power plants accepted by the environmental community are those with Integrated Gasification Combined Cycle technology, which burns coal directly instead of pulverizing it. The process burns coal, turns it into a gas, and the gas is then consumed. In the conversion process, carbon dioxide is captured, sequestered, and put into the ground in caves.

City Manager King informed Council that staff would be contacting the rating agencies to advise them of Lodi's year end cash position. The rating agencies had previously conveyed that Lodi's communication regarding its financial condition had not been adequate, and the City is now taking a proactive approach. There is the possibility that it may be a good hydroelectric year due to the abundance of water and that inexpensive power may be available later in the year; however, staff stands behind its action to secure power and lock up the power costs. The fiscal year 2006-07 budget will be balanced, without the use of reserves. There will be a small cash reserve margin, but it will not be a large enough cushion to protect against any unexpected events.

Mayor Pro Tempore Johnson questioned whether or not the City could trade or sell its higher priced power if it ended up having an abundance, to which Mr. Morrow responded in the negative.

C. COMMENTS BY THE PUBLIC ON NON-AGENDA ITEMS

None.

D. ADJOURNMENT

No action was taken by the City Council. The meeting was adjourned at 7:56 a.m.

ATTEST:

Jennifer M. Perrin
Deputy City Clerk